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No. 92-1546

Supreme Court, U.S.
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In the Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES OF AMERICA, PETITIONER

v.

JOHN O. IRVINE AND FIRST TRUST NATIONAL ASSOCIATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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1. Respondents err in asserting (Br. in Opp. 22-24) that this case does not present a recurring issue of substantial importance to the administration of the tax laws. As the petition points out (Pet. 20-21), thousands of trusts created prior to enactment of the gift tax in 1932 remain in existence. The beneficiaries of those trusts control the disposition of billions of dollars of trust assets. The American Bankers Association confirms (ABA Amicus Br. 2) that "[i]n ABA's member banks there are considerable numbers of pre-1932 trusts under corporate fiduciary management which hold billions of dollars in assets." Relying upon the opinion of the court of appeals, a large number of individuals who have contingent

remainder interests in such trusts may now seek to disclaim those interests on a tax-free basis, even though they may have known of the existence of the interests and controlled their disposition for many years.

It is, of course, difficult to estimate with precision the magnitude of the impact of the decision of the court of appeals. It is evident, however, that the decision in this case creates significant new opportunities for gift and estate tax avoidance by members of the wealthiest class of taxpayers.[1] Because of the conflict that now exists among the circuits on the tax treatment of such disclaimers, these taxpayers will be unable to pursue their important gift and estate planning decisions with certainty. See ABA Amicus Br. 3 ("Such confusion in the law is disruptive" to the formation of irrevocable estate planning decisions.). Resolution by this Court of this important, recurring issue is needed to avoid continuing uncertainty and inconsistent application of the revenue laws.

2. The holding of the court of appeals in this case—that a disclaimer of an interest in a pre-1932 trust is not subject to the gift tax—contradicts the conclusion of this Court in *Jewett* v. *Commissioner*, 455 U.S. 305 (1982), that the gift tax "unquestionably encompasses an indirect transfer, effected by means

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[1] Gift tax returns and claims for refund based upon the decision in this case have already been submitted by taxpayers seeking to take advantage of its holding. For example, the refund claim in *Perkins* v. *United States*, No. 93-10940T (D. Mass. filed Apr. 29, 1993), which involves the disclaimer of a remainder interest in a testamentary trust created in 1926, was brought less than four months after the filing of the *en banc* decision in this case.

of a disclaimer, of a contingent future interest in a trust" (*id.* at 310). In contending that "[t]he result in this case does not conflict with *Jewett*" (Br. in Opp. 15),[2] respondents ignore that the gift tax reaches all direct and indirect transfers of "property, however conceptual or contingent" (*Jewett* v. *Commissioner*, 455 U.S. at 310 (quoting *Smith* v. *Shaughnessy*, 318 U.S. 176, 180 (1943)). Here, as in *Jewett*, the practical effect of Mrs. Irvine's disclaimer was "to reduce the expected size of [her] taxable estate and to confer a gratuitous benefit upon the natural objects of [her] bounty" (*Jewett* v. *Commissioner*, 455 U.S. at 310). Mrs. Irvine's disclaimer of her remainder interest in the trust—an interest which she renounced decades after its creation—unquestionably constitutes a "transfer of property by gift" (26 U.S.C. 2501(a)(1)) to which the gift tax applies under *Jewett*.

Section 25.2511-1(c)(2) of the Treasury Regulations (26 C.F.R. 25.2511-1(c)(2))—which respondents contend distinguishes this case from *Jewett* (Br. in Opp. 15)—merely creates a limited exception, or safe harbor, from application of the gift tax to disclaimers made "within a reasonable time" after the disclaimant became aware of the interest. 26 C.F.R. 25.2511-1(c)(2). If the disclaimer does not come within the narrow terms of the exception, it remains taxable under the statute and the general provisions of the regulation. See 26 C.F.R. 25.2511-1(c)(1) ("any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift

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[2] Recognizing that their purported distinction of *Jewett* is unpersuasive, respondents contend in the alternative that "*Jewett* should be reconsidered" (Br. in Opp. 28).

subject to tax"). Under any definition of a "reasonable time," Mrs. Irvine's 1979 disclaimer of her interest in a trust created in 1917—an interest of which she was aware by no later than 1932—does not qualify under the safe-harbor regulation. See *Jewett* v. *Commissioner*, 455 U.S. at 318-319.

Contrary to respondents' contention (Br. in Opp. 19), *Jewett* is not distinguishable from this case on the ground that the interest disclaimed by the taxpayer in this case was created before the gift tax was enacted in 1932. Respondents, and the court of appeals (see Pet. 14-15), have confused the transaction to which the gift tax applies: the tax applies to the 1979 disclaimer, not to the 1917 transfer in trust. In *United States* v. *Jacobs*, 306 U.S. 363 (1939), this Court emphasized this very distinction. In *Jacobs*, the Court rejected a taxpayer's claim that an estate tax provision enacted in 1924 could not be applied to include the assets of a trust created in 1909 into an estate formed after the statute was enacted (*id.* at 366-367):

> [T]he tax was not levied on the 1909 transfer and was not retroactive. * * * [T]he tax does not operate retroactively merely because some of the facts or conditions upon which its application depends came into being prior to the enactment of the tax.

Here, as in *Jacobs*, the post-enactment transfer (by disclaimer) of an interest in the pre-enactment trust represented "a change in the nature of ownership of property [that] was designated by Congress as an appropriate occasion for the imposition of a tax." *Id.* at 371.

3. The decision of the court of appeals in this case is also in acknowledged conflict with the decision of the Eleventh Circuit in *Ordway* v. *United States*, 908 F.2d 890 (1990), cert. denied, 111 S. Ct. 2916 (1991). The Eleventh Circuit concluded in *Ordway* that an identical, long-delayed disclaimer by Mrs. Irvine's brother of a remainder interest in the same trust is subject to the federal gift tax. The Eighth Circuit held in this case, by contrast, that Mrs. Irvine's disclaimer is not subject to the gift tax and that the contrary conclusion and analysis of the Eleventh Circuit in *Ordway* is "inappropriate and misplaced" (Pet. App. 8a).

Disagreeing with the court's understanding of its own opinion, respondents contend that "the *Irvine* and *Ordway* judgments do not present a square conflict" (Br. in Opp. 20) because "Mrs. Irvine's time for making an effective disclaimer * * * expired *before* enactment of the Gift Tax Act" (*ibid.*), while "Ordway's time for disclaimer did not begin to run until *well after* enactment of the gift tax" (*ibid.*). That alleged factual disparity, however, represents a distinction without a difference. Neither Mrs. Irvine nor her brother disclaimed their remainder interests in the Ordway trust until the termination of the trust in 1979, long after they had attained their majorities and become aware of their trust interests. It is irrelevant that Mrs. Irvine, but not Mr. Ordway, *could* have filed an effective disclaimer before the gift tax was in force. Because each of them waited a period of several decades to make the disclaimer in 1979, it cannot be said by any factual standard that the disclaimer either by Mr. Ordway or by Mrs. Irvine was made within a "reasonable time," as the safe-

harbor regulation requires. See *Jewett* v. *Commissioner*, 455 U.S. at 318-319. The disclaimers in both cases are therefore subject to the gift tax. See *ibid.*

For the reasons stated herein and in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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